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GRAY DRUG STORES, INC.

Annual report to shareholders
FOR THE YEAR ENDED JUNE 30, 1958

G R A Y

DRUG STORES, INC.

MAIN OFFICE AND WAREHOUSE
2400 SUPERIOR AVENUE
CLEVELAND, OHIO

CITIES:	STORE UNITS: (June 30, 1958)
• Akron, O.	7
• Alliance, O.	1
• Ashtabula, O.	2
• Bradford, Pa.	1
• Canton, O.	4
• Chillicothe, O.	1
• Cincinnati, O.	10
• Cleveland, O.	22
• Columbus, O.	18
• Covington, Ky.	1
• Dayton, O.	4
• Hamilton, O.	1
• Mansfield, O.	4
• Massillon, O.	2
• Newport, Ky.	1
• Painesville, O.	2
• Sandusky, O.	2
• Sheffield, O.	1
• Springfield, O.	1
• Steubenville, O.	2
• Warren, O.	3
• Willoughby, O.	1
• Wooster, O.	2
• Youngstown, O.	9

Gray Drug Stores, Inc. — operating 102 stores and employing 2100 people as of June 30, 1958 — ranks eighth in size among the nation's drug chains. Grays' 21-county area dominates Ohio and borders into Kentucky and Pennsylvania. According to latest census information, 82% of Ohio's homes are located in the counties served by Gray stores.

(* To open during current fiscal year.)

BOARD OF DIRECTORS

CARLYLE W. EVANS ..... President, Gray Drug Stores, Inc.
HENRY H. GRAY ..... Vice-President, Gray Drug Stores, Inc.
CHARLES B. MERRILL ..... President, Merrill, Turben & Co.
GEORGE F. PRYOR ..... Vice-President, The Cleveland Trust Co.
JOHN W. REAVIS ..... Partner, Jones, Day, Cockley & Reavis
ADOLPH WEINBERGER ..... Chairman of the Board, Gray Drug Stores, Inc.
CARL WEINBERGER ..... Buyer, Gray Drug Stores, Inc.

OFFICERS

ADOLPH WEINBERGER ..... Chairman of the Board
CARLYLE W. EVANS ..... President
LLOYD C. DOUGLASS ..... Vice-President & Treasurer
HERBERT H. DURR ..... Vice-President
HENRY H. GRAY ..... Vice-President
MARVIN L. KAHN ..... Vice-President
MILTON M. NEUBAUER ..... Vice-President
JEROME WEINBERGER ..... Vice-President
LOUIS BERWITT ..... Secretary
ROBERT E. BREIG ..... Assistant Treasurer
JOSEPH VALINS ..... Assistant Secretary

TRANSFER AGENT AND REGISTRAR

THE CLEVELAND TRUST COMPANY ..... Cleveland, Ohio

AUDITORS

ERNST & ERNST ..... Cleveland, Ohio

COUNSEL

JONES, DAY, COCKLEY and REAVIS ..... Cleveland, Ohio

STOCK LISTED

MIDWEST STOCK EXCHANGE ..... Chicago, Illinois

REPORT TO STOCKHOLDERS

We present in this report the results of your Company's 30th year in operation.

Net sales of $32,249,706 were again the greatest in our history, representing a 9.9% increase over the previous year's sales of $29,333,474. Consolidated net income after taxes was $692,322, equivalent to $4.43 per share on 156,414 shares, as compared with $690,880, or $4.42 per share on 156,164 shares the previous year.

During the past year, your Company continued to expand through the acquisition of twelve stores formerly operated by King Drug Co. in the Cincinnati area, and the opening of six new units. Two smaller stores were sold, and ten older stores remodeled. As of June 30, 1958 we had 102 units in operation, compared to 86 on June 30, 1957.

For the current year our expansion plans call for the opening of eight more new stores and the remodeling of twelve present stores. We still have some marginal units which may be eliminated this year.

Another major improvement was the opening of our own photo-finishing plant in Cleveland, as shown on the next page. Also, our Columbus plant, in successful operation many years, was relocated and modernized.

We take pleasure in reporting the election of three new vice-presidents last year. These three young men — Herbert Durr, Marvin Kahn and Jerome Weinberger — all hold responsible executive positions with your Company.

On April 1, 1958, our employees' pension fund plan was amended and a supplemental plan adopted, to more effectively provide retirement benefits and eliminate inequities caused by economic changes since the inception of the plan in 1944. The amended plan now provides for equivalent benefits on a non-insured basis through contributions to a corporate trustee, rather than through the purchase of individual annuity contracts. The supplemental plan provides added benefits for certain classes of employees.

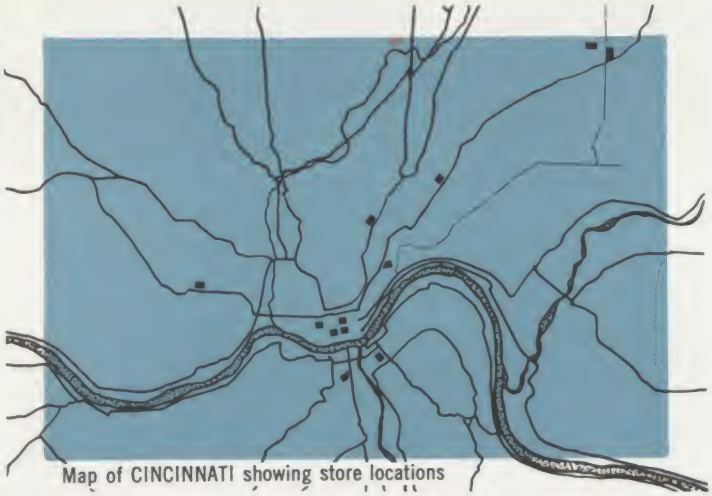
During the latter part of the year we completed a franchise agreement with the Rexall Drug Company for the sale and promotion of "Rexall" brand merchandise in our stores. This, in effect, couples the powerful national advertising and acceptance of Rexall products with the local dominance of Gray drug stores. In the opinion of Company management, the move will result in far-reaching long-range benefits. The program of integration and store identification is planned by geographic territories, to start in September 1958, and to be completed by 1961.

The past year's results were made possible by the confidence of our customers and suppliers, the continued support of our stockholders, and the loyalty of our employees. To them all, our warm appreciation and sincere thanks.

Respectfully,

Adolph Weinberger CHAIRMAN OF THE BOARD

PRESIDENT



Map of CINCINNATI showing store locations

GRAY DRUG STORES EXPAND TO COVER CINCINNATI AREA

In March, 1958, your Company assumed dominance of the Cincinnati market through the purchase of eleven stores operated by King Drug Co., largest chain in the local area. Since Gray's had formerly opened one store in Cincinnati, we now operate twelve stores in the area — including two in the neighboring communities of Covington and Newport, Ky.

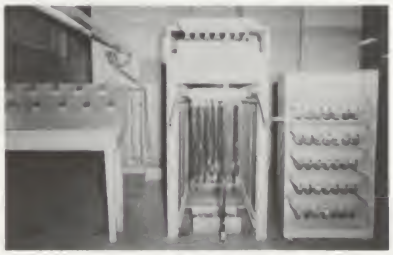
In September, 1958, an "all-out" promotional campaign will spearhead the change of signs which will integrate these units with the "Gray Drug" operation.

NEW PHOTO-FINISHING PLANT

FOR GREATER PHOTO SALES AND PROFITS

Your Company now operates two of the most modern, electronically equipped photo-finishing plants in Ohio. Experience gained through operations in Columbus showed that company-owned plants could bring greater sales, higher profits. This led to opening of a second plant to service northern Ohio, and the relocation and modernization of Columbus facilities.

The new plants now service 67 of Grays' stores and are expected to account for over $500,000 in retail sales.



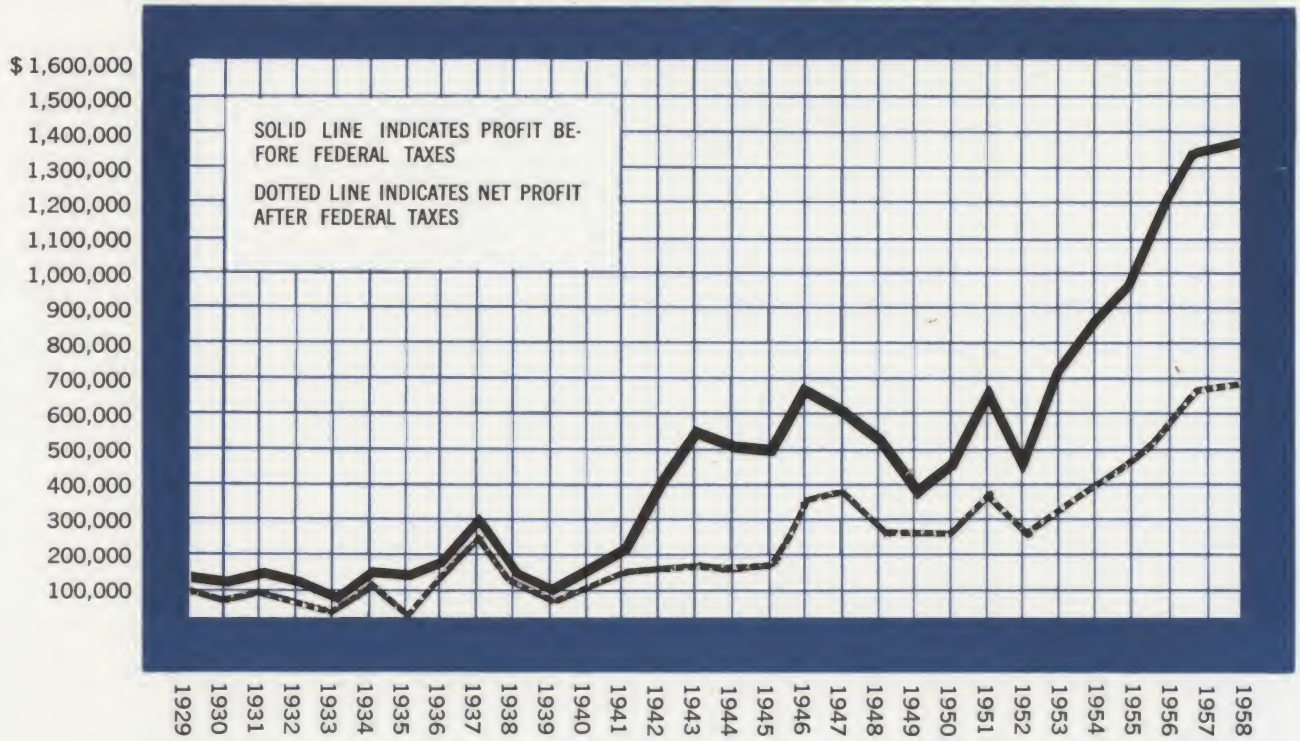
Outside view, filmachine, 432 rolls per hour

Printing room electronic machines

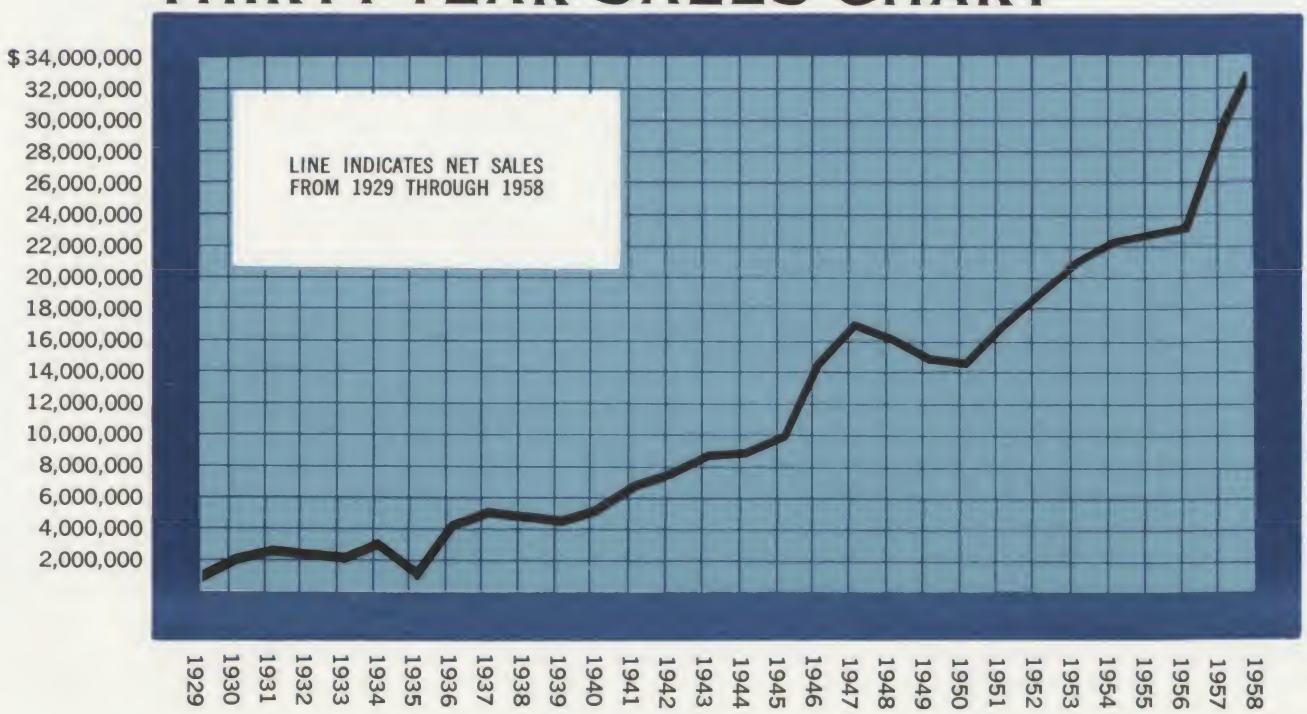
Outside processing finishing department

PROGRESS REPORT

THIRTY-YEAR PROFITS CHART



THIRTY-YEAR SALES CHART



COMPANY GROWTH

THIRTY YEAR RECORD OF PROGRESS

Fiscal	Stores End of Year	Net Sales	Net Income (3)	Earnings Per Common Share (4)	Dividends Paid Per Share
1929	17	$ 1,531,636	$120,107	$1.94	$ .81
1930	21	2,136,818	88,655	1.18	.97
1931	24	2,604,609	100,482	1.30	.98
1932	26	2,547,357	87,893	1.16	1.00
1933	26	2,498,932	80,382	1.06	1.00
1934	29	3,201,663	112,408	1.49	1.00
1935 (1)	29	1,790,809	57,587	.76	.50
1936	33	4,406,753	163,774	2.05	1.05
1937	37	5,384,723	243,088	3.04	1.90
1938	38	5,374,763	132,821	1.66	1.60
1939	38	5,154,803	113,863	1.42	.50
1940	40	5,509,435	139,430	1.74	.75
1941	39	6,925,221	172,476	1.92	1.00
1942	44	7,965,870	176,651	1.96	.75
1943	43	9,135,763	193,896	2.15	.50
1944	43	9,469,467	172,278	1.91	.75
1945	78	10,003,588	175,407	1.78	1.00
1946	91	14,700,500	366,910	2.47	1.22½
1947	91	17,496,500	388,284	2.80	1.30
1948	78	16,227,105 (2)	293,263	2.11	1.30
1949	79	15,643,806	241,014	1.74	1.05
1950	77	15,283,817	281,994	2.03	.80
1951	74	16,833,818	324,702	2.32	.80
1952	80	19,268,081	250,767	1.78	1.00
1953	78	21,075,426	327,898	2.32	1.00
1954	80	22,578,421	407,643	2.85	1.00
1955	78	23,390,391	470,560	3.20	1.00
1956	81	25,543,059	576,429	3.92	1.10
1957	86	29,333,474	690,880	4.42	1.40
1958	102	32,249,706	692,322	4.43	1.40

(1) Six months ended June 30, 1935. Changed fiscal year from calendar year to one ending June 30.

(2) In addition to the drop in sales resulting from the sale of thirteen stores, at the beginning of this year state cigarette excise taxes are excluded from sales.

(3) Before reflecting reserves for contingencies which were restored to earnings retained in the business as of June 30, 1948.

(4) Based upon the number of shares outstanding at the end of each year, adjusted to reflect a stock split of 2 for 1 in February, 1930, and stock dividends of 3% in 1931 and 2% in 1932.

NEW STORES fash

During the past year, your Company continued its planned expansion program, opening six new stores and remodeling ten. On these pages are various views of a typical new unit — designed for maximum traffic and located in a large new shopping center. Stores such as these assure the future maintenance of Grays' leadership in sales and consumer acceptance.

"Self-Service" merchandising

Cigar Dept. occupies lobby island

ioned for the future

Giant sign dominates store front

Colonial motif at Prescription Dept.

Grays' "Dutch Oven" Restaurant

CONSOLIDATED BALANCE SHEET

GRAY DRUG STORES, INC.

ASSETS

CURRENT ASSETS			
Cash			$ 1,354,097
Accounts receivable, less allowance of $10,000			169,371
Estimated refundable federal taxes on income			44,292
State tax stamps			88,357
Inventories — priced generally on the basis of the lower of cost (latest) or replacement market:			
At stores		$4,328,253	
At warehouse		1,825,777	
		$6,154,030	
In transit		143,443	6,297,473
Prepaid expenses			143,040
TOTAL CURRENT ASSETS			$ 8,096,630
OTHER ASSETS			120,839
FIXED ASSETS — on the basis of cost			
Furniture and fixtures	$3,083,382		
Leasehold improvements	2,143,764	$5,227,146	
Less allowances for depreciation and amortization		2,249,322	2,977,824
			$11,195,293

AND SUBSIDIARIES . . . JUNE 30, 1958

LIABILITIES AND SHAREHOLDERS' EQUITY

CURRENT LIABILITIES		
Notes payable to bank		$ 700,000
Portion of long-term debt due within one year		411,652
Accounts payable and accrued expenses:		
Trade accounts	$1,579,921	
Salaries, wages, and commissions	418,441	
Accrued expenses	308,655	
Rent and interest	169,752	
Payroll taxes and amounts withheld from employees	113,000	
Taxes other than federal taxes on income	154,932	2,744,701
Federal taxes on income — estimated		548,319
TOTAL CURRENT LIABILITIES		$ 4,404,672
LONG-TERM DEBT — Note A		
Note payable to insurance company	$ 576,378	
Note payable to others	366,700	
	$ 943,078	
Less portion classified as current	411,652	531,426
SHAREHOLDERS' EQUITY		
Capital stock, par value $1 a share — Note B:		
Authorized — 200,000 shares		
Outstanding — 156,414 shares	$ 156,414	
Capital in excess of par value — Note C	2,061,409	
	$2,217,823	
Earnings retained for use in the business — Note A	4,041,372	6,259,195
		$11,195,293

See notes to financial statements.

STATEMENT OF CONSOLIDATED EARNINGS RETAINED FOR USE IN THE BUSINESS

GRAY DRUG STORES, INC., AND SUBSIDIARIES
YEAR ENDED JUNE 30, 1958

Balance at July 1, 1957		$ 3,567,768
Net income for the year		692,322
		$ 4,260,090
Cash dividends declared:		
$.35 a share paid October 1, 1957	$ 54,657	
$.35 a share paid January 1, 1958	54,658	
$.35 a share paid April 1, 1958	54,658	
$.35 a share paid July 1, 1958 — Note D	54,745	218,718
BALANCE AT JUNE 30, 1958		$ 4,041,372

See notes to financial statements.

STATEMENT OF CONSOLIDATED INCOME

GRAY DRUG STORES, INC., AND SUBSIDIARIES
YEAR ENDED JUNE 30, 1958

Net sales	$32,249,706
Cost of goods sold	19,994,544
	$12,255,162
Other operating income	96,557
	$12,351,719
Selling, general, and administrative expenses	10,922,800
	$ 1,428,919
Other income	18,217
	$ 1,447,136
Interest expense	75,814
INCOME BEFORE FEDERAL TAXES ON INCOME	$ 1,371,322
Federal taxes on income — estimated	679,000
NET INCOME	$ 692,322

See notes to financial statements.

NOTES TO FINANCIAL STATEMENTS

GRAY DRUG STORES, INC., AND SUBSIDIARIES
YEAR ENDED JUNE 30, 1958

Note A — The loan agreement with an insurance company provides for interest at the rate of 3¾% per annum, for repayment in semiannual installments of $50,000, and for additional payments each year equal to 20% of the excess of consolidated net income for the preceding year over $280,000 ($82,464 will be due on November 1, 1958, under such requirement); however, each additional payment shall not exceed $100,000. The loan agreement, and a credit agreement with a bank include certain provisions relating to the maintenance of consolidated net current assets and restrictions on the payment of dividends. Accordingly, consolidated earnings retained for use in the business available for dividends amounted to $1,191,958 at June 30, 1958.

The note payable to others provides for interest at the rate of 4½% per annum, and for repayment in quarterly installments of $45,837.

Note B — On May 24, 1955, options were granted to certain officers and key employees (three of whom are directors) to purchase 15,000 shares of the capital stock of the Company. The option price was $16.37½ per share, which represents the quoted market value at the date of the grant, except that the option price to two employees (related to principal shareholder) was $18.70 per share to permit qualification as a restricted stock option. The aggregate option price of all shares was $253,995.

On May 24, 1957, all of the options became exercisable. During the year ended June 30, 1958, options for 250 shares were exercised and at June 30, 1958, 5,511 shares were subject to options expiring May 23, 1960.

Note C — The increase of $3,844 in capital in excess of par value represents the excess of proceeds from sales of 250 shares of capital stock sold under the Company's stock option plan over the aggregate par value of such shares.

Note D — The Company deposited funds with a dividend disbursing agent on June 30, 1958, for the dividend payable on July 1, 1958.

Note E — The companies were lessees at June 30, 1958, under a number of leases extending from one to eighteen years. The aggregate annual minimum rental payable (many of such leases provide for additional rental if amounts based on specific percentages of sales exceed the minimum) amounted to approximately $1,453,000.

Note F — Allowances for depreciation and amortization aggregated $507,717 for the year.

Note G — Total contributions under the pension plan for employees of the companies amounted to approximately $150,000 for the year ended June 30, 1958, including amortization of the cost of past service benefits to retirement age of participants. At June 30, 1958, the unfunded cost of past service benefits was approximately $27,000.

ACCOUNTANT'S REPORT

Board of Directors,
Gray Drug Stores, Inc.
Cleveland, Ohio.

We have examined the consolidated financial statements of Gray Drug Stores, Inc. and subsidiaries for the year ended June 30, 1958. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying balance sheet and statements of income and earnings retained for use in the business present fairly the consolidated financial position of Gray Drug Stores, Inc. and subsidiaries at June 30, 1958, and the consolidated results of their operations for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

ERNST & ERNST
Certified Public Accountants

Cleveland, Ohio
August 25, 1958

GRAY
DRUG STORES